

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0394
Gross Income Tax / Withholding Liability
For 1999, 2000, and 2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

I. Withholding Gross Income Tax.

Authority: IC 6-2,1-2-2(a); IC 6-2,1-6-1; 45 IAC 1.1-5-8.

Taxpayer challenges an audit decision requiring it to withhold gross income tax on payments made to certain non-resident contractors.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty on the ground that taxpayer did not act with willful negligence or intentional disregard of Indiana's tax laws.

STATEMENT OF FACTS

Taxpayer operates a network of retail stores selling various types of merchandise. Taxpayer operates approximately 100 retail stores and distribution centers within the state.

The Department of Revenue (Department) conducted a sales and use tax audit review of taxpayer's business records and tax returns. During the course of that audit, a number of payments to vendors were reviewed to determine whether or not the payments were subject to the requirement to withhold Indiana gross income tax. The list of vendors was checked against the Indiana Secretary of State's records to determine if the vendors were registered to conduct business within the state. Thereafter, the taxpayer was provided a list of those vendors for which verification could not be made. Taxpayer was asked to provide documentation demonstrating that the payments to those vendors were not subject to the withholding tax. Taxpayer declined the opportunity to provide that documentation at the time the audit review was conducted.

The audit found that the payments to the non-resident contractors were subject to the withholding requirement. During June of 2004, the Department sent taxpayer notices of "Proposed Assessment." Taxpayer submitted a protest challenging certain aspects of the proposed assessment. Taxpayer declined the opportunity to take part in an administrative hearing or to further explain the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Withholding Gross Income Tax.

Indiana formerly imposed an income tax, known as the gross income tax, upon the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a). Except as provided in IC 6-2.1-6-1, each calendar year, each individual, firm organization or governmental agency of any kind which made payments to a nonresident contractor for performance of any contract, except contracts for sale, was required to withhold from such payments the amount of gross income tax owed upon the receipt of those payments. IC 6-2.1-6-1.

The withholding requirement is further clarified at 45 IAC 1.1-5-8, in effect during the tax periods at issue. The regulation states in part as follows:

For taxable years beginning after December 31, 1993, a withholding agent who is required to withhold gross income tax under IC 6-2.1-6-1 or IC 6-2.1-6-2 is required to file a return and pay the tax withheld to the department on April 20, June 20, September 20, and December 20 of each calendar year. The return shall show the amount withheld from the gross income paid to each taxpayer. (b) The withholding agent is not liable to a taxpayer for any amounts withheld and paid to the department in accordance with this section. (c) Gross income tax should not be withheld on the first one thousand dollars (\$1,000) paid to a taxpayer during a taxable year. (d) The amount of gross income tax withheld shall be determined by applying the high rate of tax to the total amount of gross income without any deductions.

The audit review determined that taxpayer did not – but should have – withheld gross income tax on payments made to non-resident contractors during 1999, 2000, and 2001.

During 1999, the audit determined that taxpayer should have withheld gross income tax from payments made to six different contractors. The amount of withholding liability was approximately \$68,800.

During 2000, the audit determined that taxpayer should have withheld gross income tax from payments made to four different contractors. The amount of withholding liability was approximately \$164,000.

During 2001, the audit determined that taxpayer should have withheld gross income tax from payments made to four different contractors. The amount of withholding liability was approximately \$189,600.

A. Withholding Liability.

The total amount of withholding liability for 1999, 2000, and 2001 was approximately \$422,400.

In taxpayer's protest letters, taxpayer supplied the Indiana identification numbers for two of the contractors. Taxpayer paid for a portion of the outstanding withholding liability. To the extent that taxpayer has verified that certain of the contractors were registered to do business in Indiana and paid the gross income tax on the payments received from taxpayer, taxpayer's protest of the corresponding assessment is sustained.

To the extent that taxpayer has paid the remaining portion of the outstanding withholding liability, the issue is – of course – moot.

B. Interest.

Taxpayer requests that the interest assessed on the outstanding gross income / withholding liability be abated. IC 6-8.1-10-1(a) states that upon a taxpayer's failure to pay the full amount of tax due, the taxpayer "is subject to interest on the nonpayment." The taxpayer's request for abatement of the interest assessed is unavailing. The interest assessed for late payment under IC 6-8.1-10-1(a) is not subject to the Department's discretionary review. The statute simply states that upon finding a payment deficiency, the taxpayer "*is* subject to interest on the nonpayment." (*Emphasis added*). Absent the statutory or equitable authority to abate the interest properly imposed under IC 6-8.1-10-1(a), the Department must decline the taxpayer's invitation to do so.

FINDING

Taxpayer's protest is denied in part and sustained in part. To the extent that taxpayer has demonstrated that the contractors were registered to conduct business in Indiana, taxpayer's protest is sustained. To the extent taxpayer has paid a portion of the outstanding gross income / withholding liability, the issue is moot. Taxpayer's request to abate the amount of interest attributable to the unpaid gross income / withholding liability, taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Claiming that it exercised "prudence and ordinary care," taxpayer requests that the Department exercise its discretionary authority to abate the ten-percent penalty. Taxpayer claims that expansion of its business "provided new opportunities for employment of Alabama residents." Taxpayer also argues that since conclusion of the audit, it "initiated additional internal controls to promote proper reporting."

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) permits the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed"

During the most recent audit, taxpayer was asked verify that the contractors in question were registered to conduct business in Indiana and to verify that payments to these contractors were not subject to the gross income / withholding requirement; taxpayer declined the opportunity to do so. The gross income tax / withholding issue was addressed in a previous Indiana audit after which a Letter of Finding was issued supporting the Department's position. The Department must conclude that taxpayer's most recent failure to address its gross income / withholding responsibility does not represent the exercise of the "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is respectfully denied.